

Risk Scoping Activities

Consider the following procedures at each examination. Examiners are encouraged to exclude items deemed unnecessary. This procedural analysis does not represent every possible action to be taken during an examination. The references are not intended to be all-inclusive and additional guidance may exist. Many of these procedures will address more than one of the Standards and Associated Risks. For the examination process to be successful, examiners must maintain open communication with bank management and discuss relevant concerns as they arise.

INSTRUCTIONS

This module will help the examiner-in-charge determine the examination scope, allocate staff resources, and prepare a pre-examination memorandum.

ACTIVITY IDENTIFICATION

1 Review the following sources to identify the significant or higher risk activities of the bank, including off-balance sheet activities and other proposed ventures.

- 1 A 1 Previous regulatory examination reports, if applicable.
2. Examination workpapers.
3. Correspondence files for various issues including applications or other supervisory matters with continuing conditions or commitments.
4. UBPR and Bank Holding Company Performance Reports.
5. Call Reports.
6. Strategic plans and budgets.
7. Internal management reports.
8. Board of director's packages.
9. Annual reports.
10. Auditors' reports, management letters, and external reviews (e.g., Loans, IRR).
11. Offsite surveillance systems.
12. Growth monitoring system.
13. Real Estate Stress Tests (FDIC).
14. Problem Bank Review Summaries.
15. Interest Rate Risk Reports (FDIC: IRRSA).
16. Early warning system reports (FDIC: Liquidity model report. Refer to RD memorandum 97-043).
17. Press releases and published news stories.
18. Alternative sources of information such as on-line databases (available to case managers), which include data about a bank's market area.
19. Regional Outlook published by the Division of Insurance (FDIC).
20. LIDIS and BIDIS (FDIC: large institutions).

(Note: Many of these resources are available through the on-line information services of the FDIC library, such as Forest and Trees.)

2 Schedule a pre-examination visit to the bank or conduct a telephone conversation with management if a meeting is not feasible. This meeting or discussion should focus on changes to bank policies, strategic direction, management information systems, electronic and internet banking activities, and significant activities that have occurred since the previous examination. The meeting also provides the examiner-in-charge with management's perspective about economic conditions, internal and external audit programs, and the risk management process.

2 A Identify economic conditions that may have a direct or indirect impact on the bank's overall financial condition. Discuss with senior management the following issues:

- 2 A1 1. The bank's primary trade area and the principal types of businesses within the area. Include, if possible, the size of the bank's trade area (for example, boundary

description, population, per capita income, and employment growth and unemployment rates, if available).

2. Management's views regarding the trends of the bank's local economy.
3. Local economic conditions that positively or negatively affect the bank (for example, new businesses or expansion plans, business closings or planned layoffs).
4. Other factors that could adversely affect local economic conditions.
5. Types of loans currently emphasized by the bank and any material changes in loan types or volume.
6. The competition in the bank's area and how it affects the bank's pricing.
7. The bank's dependence upon a particular industry or economic sector (for example, oil and gas, government, agriculture).

2 B Identify operational and functional changes. Determine if there have been any changes, or if any changes are anticipated, in the following areas:

- 2 B1 1. The bank's overall objectives or management philosophy.
2. Key personnel and ownership.
3. Investment strategies or brokers.
4. Operations, including information systems.
5. Policies and procedures.
6. Formal committee structure.

2 C Determine what senior management considers to be the highest risk areas.

3 Review the findings of the internal auditor or other personnel responsible for evaluating internal controls. As part of the evaluation, review the following items:

3 A Independence and experience of personnel conducting control reviews, adequacy of staff size, appropriateness of audit schedule, and sufficiency of scope.

3 B Effectiveness of internal control review.

3 C Audit reports and management's written response to auditors' findings.

3 D Workpapers, if necessary.

4 Review the findings of the external auditors.

Notes: Examiners should contact the external auditor to gain insight into the control environment (FDIC).

4 A Typically, examiners should review the external auditors' workpapers if the following circumstances exist: (FDIC: On 4 and 5 composite rated institutions, examiners are required to review the external auditor's workpapers. Once a determination is made to conduct a workpaper review, a request must be made in writing by either the Regional Director, Deputy Regional Director, or Assistant Regional Director to the office of the accountant.)

- 4 A1 1. Internal control problems.
2. Aggressive accounting practices.
3. Substantial exposure to high-risk activities (trading, derivative securities).

5 Determine the perceived control risks within the bank based on specific internal control weaknesses identified by the internal or external audits, in the previous examination, or by other control procedures.

6 Review information regarding consumer complaints or problems noted in other specialty areas (trust, IS, e-banking, NDIP) and determine the potential for safety and soundness concerns.

RESOURCE ALLOCATION

7 Review the relevant examination modules and identify those areas and procedures expected to warrant greater emphasis.

8 Allocate resources accordingly based on the bank's activities, the preliminary assessment of the control environment, and the areas targeted in the examination modules.

SCOPE MEMORANDUM

9 Prepare a scope memorandum. The scope memorandum should be tailored to the size and complexity of the bank and define the objectives of the examination. Address growth expectations, management or ownership changes, and the status of prior examination criticisms. Include the following information:

9 A Summary of pre-examination meeting or discussion.

9 B Summary of audit and internal control environment.

9 C Preliminary risk assessment addressing CAMELS components.

9 D Assess credit, market, liquidity, operational, legal, and reputational risk associated with the institution.

9 E Summary of examination procedures. Include a discussion of the modules to be completed and the depth of coverage in different areas.

9 F Summary of anticipated loan review.

9 G Examination staffing.